BEFORE THE
TENNESSEE STATE BOARD OF EQUALIZATION

In Re:	*John M. Higgins*	)	
	01-076-076-030.00L-001	)	
	David Hairrell	)	
	01-076-076-034.00L-001	)	
	Michael E. Callaway	)	
	01-087-087-014.00L-001	)	
	Tommie J. Davis	)	
	01-087-087-015.00L-001	)	
	Phil Newman	)	
	01-087-087-019.00L	)	
	Philip S. Dooly, et al	)	
	01-087-022.00L-001	)	Polk County
	Wayne Feehrer	)	
	02-077-077-006.00L-001	)	
	Kelly Feehrer	)	
	02-077-077-007.00L-001	)	
	William A. Pettit	)	
	02-077-077-008.00L-001	)	
	Maryl Elliott (Katie Torrence, et al)	)	
	02-077-077-009.00L-001	)	
	Robert H. Robbins	)	
	02-077-077-017.00L-001	)	
	Douglas P. Swayne	)	
	02-077-077-019.00L-001	)	
	Amy Card Lillios	)	
	02-088-088-001.00L-001	)	
	Max Everhart	)	
	02-088-088-002.00L-001	)	
	Anne Longley	)	
	02-088-088-004.00L-001	)	
	Tax year(s) 2003, 2004, 2005	)	

INITIAL DECISION AND ORDER

Statement of the Case

The subject properties are presently valued for tax purposes as follows:

ID	LAND VALUE	IMPRVMT. VALUE	TOTAL VALUE	ASSESSMENT
1-76-30L-001	$164,000	$ 38,000	$202,000	$50,500
1-76-34L-001	$164,000	$ 50,700	$214,700	$53,675
1-87-14L-001	$164,000	$ 58,900	$222,900	$55,725
1-87-15L-001	$164,000	$ 28,100	$192,100	$48,025
1-87-19L-001	$164,000	$ 39,300	$203,300	$50,825
1-87-22L-001	$164,000	$ 47,100	$211,100	$52,775
2-77-6L-001	$180,000	$ 79,100	$259,100	$64,775
2-77-7L-001	$180,000	$ 69,100	$249,100	$62,275
2-77-8L-001	$180,000	$ 39,000	$219,000	$54,750
2-77-9L-001	$180,000	$ 58,600	$238,600	$59,650
2-77-17L-001	$ 80,000	$ 45,700	$125,700	$31,425

2-77-19L-001	$ 80,000	$ 17,300	$ 97,300	$24,325
2-88-1L-001	$164,000	$ 77,200	$241,200	$60,300
2-88-2L-001	$164,000	$103,000	$267,000	$66,750
2-88-4L-001	$164,000	$ 43,600	$207,600	$51,900

Appeals have been filed on behalf of the respective taxpayers with the State Board of Equalization (the "State Board") pursuant to Tenn. Code Ann. section 67-5-1412.

The undersigned administrative judge conducted a hearing of these appeals on October 18, 2005 in Chattanooga.[1] The appellants were represented by David M. Elliott, Esq., Michael E. Callaway, Esq. (Parcel Nos. 1-87-14L-001; 1-87-15L-001; 1-87-19L-001; 2-77-19L-001), and Robert H. Robbins, Esq. (Parcel No. 2-77-17L-001). Polk County Assessor of Property Randy Yates was assisted by Robert T. Lee, General Counsel for the intervening Division of Property Assessments (DPA).[2]

Findings of Fact and Conclusions of Law

Background. The parcels in question are recreation residence sites in the Parksville Lake area of the Cherokee National Forest. This land is owned by the United States Department of Agriculture (USDA) and managed by the Forest Service. The Forest Service has issued to each of the appellants a Term Special Use Permit ("Permit") that authorizes non-commercial, recreational use of the designated lot for a 20-year period ending December 31, 2008. Exhibits 6 and 8. Unless otherwise authorized by the Forest Service, this use must be exercised at least 15 days per year. Use of any site as a permanent place of residence is expressly prohibited.

Each Permit requires payment of annual rental fee based on a percentage of the appraisals of two "typical" lots – one on Sugarloaf Drive ($32,000) and one with water access only ($15,000).[3] Those appraisals, dated June 2, 1998, were commissioned by USDA and performed by Kenneth R. Woodford, MAI. Exhibits 13 and 16.

A Permit is non-transferable; it automatically terminates upon a voluntary sale of the improvements on the site. However, the purchaser "will be granted a new permit" by the Forest Service for the remainder of the original term if that person "is deemed by the authorizing officer to be qualified as a holder." Permit, section VII(C). With the written consent of the Forest

[1]Due to the common issues involved, these appeals were consolidated for expedited disposition.

[2]The last document submitted for the record in these proceedings – Mr. Elliott's post-hearing brief – was received by the State Board on November 7, 2005.

[3]The fee is adjusted annually by the percent of change in the Implicit Price Deflator-Gross National Product (IPD-GNP) index. Permit, section VI(C)(1). USDA remits a portion of the annual rental fee to Polk County in accordance with the 25% Fund Act of 1908, as amended.

Service, a Permit holder may also sublet any authorized improvements on a lot. Permit, section VII(E).

The Forest Service may revoke a Permit either for cause or, subject to payment of damages, "in the public interest." The Permit grants no option of renewal to the holder, but section IX(A)(1) does call for issuance of a new term Permit "[w]here continued use is consistent with the (Forest Land and Resource Management Plan)" for the affected area. Further, upon a determination by the Forest Service that a revision of the Forest Plan will necessitate conversion of a lot to an "alternative public use," the Permit holder has a right of continued occupancy for a period of ten years after the date of written notice.[4]

Heretofore, only the improvements on the subject parcels were assessed to the Permit holders. In 2003, a year of reappraisal in Polk County, the Assessor added the estimated values of their purported "leasehold interest" in these summer home sites.[5] The taxpayers appealed the increased assessments to the county and state boards of equalization, denying the existence of any such interest. In an interlocutory order dated March 2, 2005, the Assessment Appeals Commission concluded that:

> …[I]n their totality, the rights conferred by the permit are comparable to a lease rather than a license, and certainly rise to the level of an interest in real property assessable separately from the freehold under the applicable statute. The permit agreement effectively provides for conveying the interest, requiring only permission of the freeholder which is not an unusual limitation in a lease.
>
> As to the method of valuation,…[i]f the permittees are paying a fair market rent for the use of the cabin lots, their assessable interests in the lots have no value.

Order on Interlocutory Review, pp. 2-3. The Commission remanded the cases to the administrative judge for a determination of the values of the subject parcels (as improved).

DPA's Appraisal Methodology. The leasehold values in controversy were calculated by DPA. In the apparent absence of comparable rentals of residential property, DPA sought to derive the fair market rent for the limited use of the subject lots from various sales of summer homes in the Parksville Lake area that occurred before the January 1, 2003 reappraisal date.[6] Exhibit 10. As explained by staff appraiser Frank Creasman and regional supervisor Lynn Tenpenny, DPA subtracted from each sale price the value assigned to the existing improvements in the computer-assisted mass appraisal system. The remaining amount, DPA

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[4]Presumably, the Forest Service could still revoke the Permit during this ten-year period pursuant to section VIII.

[5]These leasehold values were entered on the "land value" line of the official property record cards.

[6]Despite the non-transferability of the Permit, some of the deeds included a so-called "assignment" of the seller's "right, title and interest in and to" it. Exhibits 1-5.

inferred, was the value attributable to the right to occupy and use the lot in the future to the extent authorized by the Permit. DPA capitalized that value at a rate of 0.10 to obtain the supposed market rent (by the "I = R x V" formula, where I = annual net operating income, R = capitalization rate, and V = value). To estimate the leasehold value, DPA discounted the amount by which the market rent exceeded the sum of the contract rent (i.e., the annual rent due under the Permit) plus a "miscellaneous" expense allowance.[7] Notwithstanding the expiration date specified in the Permit (December 31, 2008), DPA projected a term of 99 years in its original analysis. Exhibit 14.

As interpreted by DPA, the market data indicated that the Parksville Lake summer home sites fell into three categories for appraisal purposes: (1) lots having boat access only ($80,000); (2) lots located on Sugarloaf Drive ($164,000); and (3) lots located on U.S. Highway 64 ($180,000).[8] Mr. Creasman and Mr. Tenpenny did not believe that the sale prices warranted any adjustments for topographical or other differences among the lots within these groups.

Contentions of the Appellants. The appraised and assessed values of the subject improvements are not in dispute. However, without conceding ownership of any leasehold interests in the subject land, the taxpayers contended that DPA failed to comply with state law in the valuation of such interests. In this regard, Mr. Elliott emphasized that: (a) the Permit holders had no contractual rights of occupancy beyond 2008; and (b) the buyers of the comparables on which DPA relied acquired something "completely different from Appellants' right to use the property" because the Permits are non-transferable. As he put it, "[a]ll that a permittee can sell is the right of the purchaser to apply for a new permit." Post-hearing Brief, p. 7.

Further, the taxpayers argued, the Parksville Lake summer home sales were "speculative" in that the buyers had no assurance of receiving a Permit from the Forest Service. Moreover, in the appellants' view, the Permit fees equaled the fair market rent for the use of the cabin lots.[9] Some of the appellants also complained that DPA's appraisals unfairly ignored

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[7]Contrary to the appellants' assertion that they were not given "credit for the payment received by Polk County" (Post-hearing Brief, p. 2), DPA did deduct the whole amount of the base contract rent in its calculation. The fact that the county ultimately received part of that amount is immaterial in the valuation of the appellants' leasehold interests.

[8]Although there were no recent sales of Highway 64 lots prior to the 2003 reappraisal date, DPA upwardly adjusted the indicated Sugarloaf Drive lot values by a factor of 10% on account of the superior road access.

[9]Curiously, Mr. Robbins and Mr. Callaway posited that the leasehold interests should be valued by multiplying the annual Permit fee times the number of years remaining in the term. But if the Permit fee truly equaled the fair market rent for the use of the designated lot, then the Permit holder's leasehold interest would have no value under the terms of the Order on Interlocutory Review.

certain physical characteristics (e.g., steepness of grade and difficulty of access) which detracted from the values of their leasehold interests.[10]

Applicable Law. Tenn. Code Ann. section 67-5-502(d) provides that:

> All mineral interests and all other interests of whatever character, not defined as products of the soil, in real property, including the interest which the lessee may have in and to the improvements erected upon land where the fee, reversion, or remainder therein is exempt to the owner, and which interest or interests is or are owned, separately from the general freehold, shall be assessed to the owner thereof, separately from the other interests in such real estate, which other interests shall be assessed to the owner thereof, all of which shall be assessed as real property.

Under Tenn. Code Ann. section 67-5-601(a), "[t]he value of all property shall be ascertained from the evidence of its sound, intrinsic and immediate value, for purposes of sale between a willing seller and a willing buyer without consideration of speculative values…." According to subsection (b) of that section, "no appraisal hereunder shall be influenced by inflated values resulting from speculative purchases in particular areas in anticipation of uncertain future real estate markets…." Tenn. Code Ann. section 67-5-605 directs that leasehold interests be valued "by discounting to present value the excess, if any, of fair market rent over actual and imputed for the leased premises, for the projected term of the lease including renewal options."[11]

Since they seek to change the current assessments of the subject properties, the appellants have the burden of proof in this administrative proceeding. State Board Rule 0600-1-.11(1).

Analysis. As Mr. Lee pointed out, most assessments of leasehold interests involve commercial or industrial property. Unfortunately, the valuation technique mandated by Tenn. Code Ann. section 67-5-605 is not very suitable for residential properties where no active rental market exists. Such properties, of course, are commonly valued by a sales comparison approach.

That said, however inapposite the statutory methodology may be, the Assessor must obviously abide by it. At first blush, DPA's approach to solving this difficult appraisal problem seemingly departs from the law by valuing leasehold interests on the basis of sales. Yet, however dubious the extraction of market rent from sale prices may be, the administrative judge cannot conclude that the resulting appraisal is invalid as a matter of law. A paucity of

[10]Mr. Hairrell, Mr. Robbins, as well as Mr. Callaway and his clients Phil Newman and Douglas Swayne testified to this effect at the hearing.

[11]The State Board has not exercised the rulemaking power granted under Tenn. Code Ann. section 67-5-605.

comparable rental data for property that is subject to a leasehold assessment surely does not confer immunity from such an assessment on the leaseholder.

Through careful preparation and rigorous examinations of witnesses, counsel for the appellants certainly succeeded in exposing several shortcomings in DPA's research. It turned out, for example, that Mr. Creasman was unaware of the termination date of the Permits at the time of the hearings before the Polk County Board of Equalization; and Mr. Tenpenny was apparently under the impression that the Permits were freely transferable. In addition, many of the sales compiled by DPA happened in the 1990s, and were belatedly time-adjusted.[12]

Nevertheless, for their part, the taxpayers adduced no disinterested appraisal-related testimony on their own behalf. The determination of fair market rent required by Tenn. Code Ann. section 67-5-605 cannot reliably be predicated on the aforementioned appraisals for the Forest Service. Those appraisals, after all, concerned USDA's *fee simple interest* in the *raw land* – not the appellants' *leasehold interests* in the sites *as improved*. Furthermore, the effective date of Mr. Woodford's appraisals preceded the relevant assessment date by over 41/2 years. In any event, since the appraiser was not called to testify at the hearing, his opinions of value must be discounted as hearsay.

It is true that the sellers of DPA's comparables did not – and could not – really "sell" their leasehold interests in Parksville Lake lots outright. But the fact remains that the buyers of those properties willingly paid amounts far in excess of the undisputed improvement values. If anything, the buyers might have paid even greater sums for a legally enforceable assignment of the leasehold interest itself as well as the improvements.

Tellingly, none of the witnesses at the hearing knew of any instance where the Forest Service had refused to issue a new Permit to a transferee of the improvements on a Parksville Lake lot. Revocations of Permits in this area have also apparently been rare. This historical success rate, coupled with the 15-day minimum usage requirement in the Permit, militates against exclusion of these transactions as "speculative" sales.

The statutory proscription of "speculative values" in the appraisal of property for tax purposes should not be construed so rigidly as to bar consideration of anything less than a virtual certainty. Accordingly, with respect to the key concept of highest and best use, an authoritative textbook advises that:

> The appropriateness of current zoning and the **reasonable probability** of a zoning change must be considered. Highest and best use recommendations may rely on the probability of a zoning change….If the highest and best use of a site is predicated on a zoning change, the appraiser must investigate the probability that such a change will occur. The appraiser may interview planning and zoning staff and study patterns of zoning change to assess the likelihood of a change. [Emphasis added.]

[12]According to Mr. Creasman, the time adjustments to the comparable sale prices offset the effect of reducing the projected term of the Permit from 99 to 25 years.

Appraisal Institute, The Appraisal of Real Estate (12th ed. 2001), p. 194.

Nothing in the record of this proceeding suggests that, as of the January 1, 2003 reappraisal date, there was not at least a "reasonable probability" of issuance of new Permits to the appellants (or their successors) upon the expiration of the current ones in 2008. Indeed, the rapidly escalating sale prices characterized by Mr. Elliott as "inflated" (Post-hearing Brief, pp. 10-13) would not likely have been achieved in the face of any substantial doubt on this point. Moreover, even if the Forest Service were to decide that issuance of a new Permit would be inconsistent with the latest Forest Plan, the Permit holder would probably retain a right of occupancy for a ten-year period.

Finally, in recognition of the *market value* standard of review, the State Board has generally rejected complaints to the extent that they are grounded on the alleged inequity of an appraisal in comparison with the appraised values of "benchmark" or similar properties. Given the inevitable imperfections of mass appraisal systems, those values could be as inaccurate as the value of the property under appeal is claimed to be. *See*, e.g., Appeal of Green Hills Associates (Davidson County, Tax Years 1991 and 1992, Final Decision and Order, June 6, 1994), affirmed in Green Hills Associates v. State Board of Equalization (Davidson County Chancery Court, Part Three, July 21, 1995). *See also* Carroll v. Alsup *et al*., 64 S.W. 193 (Tenn. 1901). While some of the appellants identified features which may negatively affect the values of their respective leasehold interests, none introduced sufficient evidence to quantify those values.

Order

It is, therefore, ORDERED that the present valuations of the subject properties be affirmed.

Pursuant to the Uniform Administrative Procedures Act, Tenn. Code Ann. §§ 4-5-301—325, Tenn. Code Ann. § 67-5-1501, and the Rules of Contested Case Procedure of the State Board of Equalization, the parties are advised of the following remedies:

1. A party may appeal this decision and order to the Assessment Appeals Commission pursuant to Tenn. Code Ann. § 67-5-1501 and Rule 0600-1-.12 of the Contested Case Procedures of the State Board of Equalization. Tennessee Code Annotated § 67-5-1501(c) provides that an appeal **"must be filed within thirty (30) days from the date the initial decision is sent."** Rule 0600-1-.12 of the Contested Case Procedures of the State Board of Equalization provides that the appeal be filed with the Executive Secretary of the State Board and that the appeal **"identify the allegedly erroneous finding(s) of fact and/or conclusion(s) of law in the initial order"**; or

2. A party may petition for reconsideration of this decision and order pursuant to Tenn. Code Ann. § 4-5-317 within fifteen (15) days of the entry of the order. The petition for reconsideration must state the specific grounds upon which relief is requested. The filing of a petition for reconsideration is not a prerequisite for seeking administrative or judicial review.

This order does not become final until an official certificate is issued by the Assessment Appeals Commission. Official certificates are normally issued seventy-five (75) days after the entry of the initial decision and order if no party has appealed.

ENTERED this 24th day of January, 2006.

PETE LOESCH
ADMINISTRATIVE JUDGE
TENNESSEE DEPARTMENT OF STATE
ADMINISTRATIVE PROCEDURES DIVISION

cc: David M. Elliott, Esq., Grant, Konvalinka & Harrison, P.C.
Michael E. Callaway, Esq., Bell & Associates, P.C.
Robert H. Robbins, Esq.
Randy Yates, Polk County Assessor of Property
Robert T. Lee, General Counsel, Division of Property Assessments

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